UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF WISCONSIN

In re:

Case No. 09-22963

DAVID MICHAEL LARSEN,

Chapter 7

Debtor.

MEMORANDUM DECISION ON THE TRUSTEE'S OBJECTION TO THE DEBTOR'S CLAIMS OF EXEMPTION AND THE COURT'S DECISION TO ABSTAIN

This matter came before the Court on the chapter 7 trustee's objection to the debtor's claims of exemption, and the issue has now evolved into a determination as to whether a state court receiver, judgment creditors, or the debtor has a right to certain funds. This Court has jurisdiction pursuant to 28 U.S.C. § 1334 and this is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (B), & (E). Pursuant to Fed. R. Civ. P. 52, made applicable to this proceeding by Fed. R. Bankr. P. 7052, this decision constitutes the Court's findings of fact and conclusions of law. This court abstains from exercising jurisdiction over either the funds claimed exempt or the funds determined not exempt.

BACKGROUND

The debtor and his former wife commenced divorce proceedings in November 1999. (Teri S. Jendusa v. David M. Larsen, Racine County Case No. 1999FA001626). During the pendency of those proceedings, and without the consent of his former spouse, the debtor transferred marital assets, including the marital homestead, into two entities, the "Magnum Opus Investment Deed of Settlement Dated 11/2/00," registered in the West Indies and the "Velocity

Investments Family Limited Partnership," an Illinois limited partnership. The debtor was the settlor and beneficiary of the Magnum Opus trust, and the two minor daughters of the debtor and his former spouse were also named beneficiaries of the trust. The divorce was granted on January 31, 2001.

The following events were summarized in court transcripts and the judgment creditors' brief and are uncontroverted by the debtor. On the morning of the three-year anniversary of the divorce, the debtor's former spouse went to the home of the debtor to pick up their daughters. After arriving, the debtor attacked his former spouse and beat her with a baseball bat. He then bound her hands and face with duct tape to prevent her escape, stripped her of her pants, shoes and socks, placed her in a trash can partially filled with snow, and placed the trash can in the unheated cargo box of his pickup truck. He then transferred the trash can with his former spouse in it to an unheated storage space that he had previously rented, placed boxes on top of the trash can to prevent her escape, and left. His former spouse remained in the trash can for over 18 hours before she was rescued through the efforts of various police agencies and others.

As a result of the assault and abandonment in the storage facility, the debtor's former spouse suffered severe injuries, including bruising and contusions, facial lacerations, hypothermia, the loss of all ten of her toes to frostbite, and a miscarriage.

The debtor ultimately pleaded no contest to state charges of attempted homicide while

¹The Velocity Investments Family Limited Partnership is comprised of its general partner, the debtor, and four limited partners, the debtor, the debtor's brother, and the debtor's two daughters. The debtor owned 97% of the limited partners' interests. On November 2, 2000, the date of the creation of the Magnum Opus trust and the Velocity Investments Family Limited Partnership, the debtor transferred all his rights and 96% of the limited partners' interest in the Velocity Investments Family Limited Partnership to the Magnum Opus trust.

armed and interference with custody. (State of Wisconsin v. David M. Larsen, Racine County Case No. 2004CF000126). He was sentenced to 37 years in state prison. Because the debtor had transported his former spouse across state lines, he was also charged and adjudicated guilty in federal court of kidnaping under 18 U.S.C. § 1201(a)(1) and Interstate Domestic Violence under 18 U.S.C. § 2261(a)(2). (United States v. David Michael Larsen, E.D. Wis. Case No. 04-Cr-29). He was sentenced concurrently to the state case to imprisonment for a life term on the kidnapping offense and 120 months on the domestic violence offense.

The debtor's former spouse and her family commenced a civil suit against the debtor for compensatory and punitive damages. (Terri S. Jendusa Nicolai, et al. v. David M. Larsen, Racine County Case No. 2004CV000809). The civil case was stayed until the debtor was convicted of criminal charges. On June 19, 2008, the Racine County Circuit Court ruled in favor of the former spouse and her family on their claims for assault and battery, intentional infliction of emotional distress, false imprisonment, and loss of society and companionship. On July 22, 2008, the state court rendered judgment against the debtor, and in favor of the judgment creditors, as follows: The debtor's former spouse, \$3,410,785.38; the husband of the debtor's former spouse, \$201,839.54; and the debtor's children, \$50,459.89 each.

Previously, in the months following the debtor's assault and kidnaping of his former spouse, the Racine County family court had frozen all the assets of the debtor and entered an injunction prohibiting the depletion, transfer, or withdrawal of any of his assets. The court also ordered that child support for the debtor's two minor daughters be paid from the debtor's Fidelity IRA account until exhausted, and then from his Federal Thrift Savings Plan account until exhausted. (Case No. 1999FA001626). Contrary to the court order and pursuant to the debtor's

directions, the debtor's father withdrew the entire balances from the IRA and TSP accounts in September 2004. According to the debtor, the funds were withdrawn by his power of attorney for the purpose of hiring legal counsel.

On November 15, 2004, the family court ordered the appointment of a receiver under section 813.16, Wis. Stats., and Chapter 767, Wis. Stats., to take possession of the proceeds of the IRA and TSP accounts previously held in the name of the debtor, for the purpose of paying ongoing child support payments to the debtor's former spouse. (Case No. 1999FA001626). *See also* Wis. Stat. § 815.18(3)(j)5 (retirement accounts are not exempt from recovery for child support); Wis. Stat. § 767.61(4) (establishment of trust of property division awarded to child support obligor); Wis. Stat. § 767.77 (enforcement of child support by various remedies when child support payment is not made). On December 10, 2004, the same receiver was also appointed to administer certain real estate owned by the debtor in the name of the Magnum Opus Investment trust. (Case No. 1999FA001626). That order provided for the sale of the real estate and the administration of the assets but gave no direction as to disbursal of the proceeds.

On January 21, 2009, the state court granted the judgment creditors' motion for an order that the funds in the Magnum Opus trust receivership (Case No. 1999FA001626) be used to pay their civil judgments (Case No. 2004CV000809) on the grounds that the debtor was the settlor as well as the beneficiary of the trust. That ruling was set forth in the court's order dated March 2, 2009. Those trust funds were thereafter transferred to the Cannon & Dunphy, S.C., trust account on March 13, 2009, on behalf of the judgment creditors the same day the debtor filed this

bankruptcy petition.²

In April 2009, the receiver turned over the funds which had been used to pay child support to the chapter 7 bankruptcy trustee. The trustee has not paid child support. The funds held at Cannon & Dunphy are still in the firm's trust account. As of the date of this decision, the trustee was holding \$144,091.51, representing the proceeds of the debtor's former retirement accounts. The Cannon & Dunphy firm was holding \$176,826.87, representing the proceeds of the debtor's Magnum Opus account.

The debtor appealed the family court orders entered on February 10, 2009, March 2, 2009, and July 20, 2009.³ (Teri S. Jendusa v. David Larsen, Racine County Case No. 1999FA001626, Court of Appeals Consolidated Case Nos. 2009AP002017 & 2009AP000392). The debtor's motion for a stay of the March 2, 2009, order was denied by the appellate court on April 6, 2009. The debtor's appeals remain pending. The civil judgment entered on July 22, 2008, was not appealed. (Racine County Case No. 2004CV000809).

At a hearing on July 28, 2009, on the trustee's objection to the debtor's claim of exemptions, this Court found that the funds from the Velocity Investments and Magnus Opus accounts were not exempt. (Court Minute Order entered August 6, 2009). The trustee later

²The debtor argues the receiver violated the automatic stay when he transferred the funds to Cannon & Dunphy. The actions by the receiver, who had lawful possession of the subject funds at the time of the transfer, do not fall within the proscribed actions set forth in 11 U.S.C. § 362.

³The record before this court only includes the March 2, 2009, order. According to the state court docket, the February 10, 2009, order was "for payment," and the July 20, 2009, order related to a hearing held on July 8, 2009, in which the "motions requesting release of funds" were denied. This Court presumes the orders all relate to the rights of the judgment creditors in the funds traceable to the Velocity Investments and Magnum Opus accounts.

determined that the funds traceable to the Fidelity IRA and Thrift Savings Plan are not property of the estate and asked if they should be returned to the receiver or, if exempt, should be returned to the debtor. This was taken under advisement.

ARGUMENTS

The trustee's position is that pursuant to 11 U.S.C. § 541(d), at the commencement of this bankruptcy case, the debtor did not have an interest in the former retirement funds held by the trustee sufficient to include them in the bankruptcy estate. Since those funds are not property of the estate, the question on exemption becomes moot. The trustee now asks that the court determine the conflicting claims of the debtor and the judgment creditors, who want the funds returned to the receiver for payment of ongoing child support, and the trustee has stated he will return the funds to whom the court directs. He does contend, however, that the former Magnum Opus funds held by the Cannon & Dunphy firm are properly property of the estate and should be transmitted to the trustee.

The judgment creditors contend the debtor's former retirement funds are not property of the debtor's estate. They argue these assets lost their status as retirement or pension funds because they were not rolled into another qualified pension plan within 60 days of withdrawal.

See 26 U.S.C. § 402(c). After the family court created a receivership over those funds, the debtor had no right, title or interest in those funds and had held no interest for years. Those funds should be returned to the receiver for the continued payment of nondischargeable child support. Likewise, the funds from the Magnum Opus trust are not property of the estate because the state court placed them into receivership, where they have been administered since 2004, until awarded by the state court to the judgment creditors.

The debtor argues his retirement funds were illegally seized by the state court in violation of the anti-forfeiture and anti-alienation clauses of the Employee Retirement Income Security Act of 1974. None of the state court orders meet the requirements of a Qualified Domestic Relations Order. Additionally, the state court prevented the debtor's power of attorney from returning the funds to a retirement vehicle within 60 days of the initial withdrawal. Since the seizure was an event beyond the reasonable control of the individual subject to the requirement, he would be entitled to reinvest under a hardship exception. Those funds are thus exempt from the bankruptcy estate.⁴ The debtor also argues the state court seizure of the Magnum Opus funds violated the Internal Revenue Code and ERISA, and took place under the guise of providing future child support, in violation of section 767.255, Wis. Stats. The partnership assets of the Velocity Investments Family Limited Partnership are either not property of the estate under 11 U.S.C. § 541(b)(1) or are exempt pursuant to Wis. Stat. § 178.21(3)(c) (partnership assets are exempt from claims against the partners that are not claims against the partnership).

DISCUSSION

The first question is whether retirement funds, withdrawn and not reinvested, are property of the bankruptcy estate. Section 541(a) of the Bankruptcy Code delineates property within the perimeters of "property of the estate." Included within "property of the estate" are interests existing as of the filing of a debtor's case, 11 U.S.C. § 541(a)(1) & (2), those recovered by or preserved for the estate, 11 U.S.C. § 541(a)(3) & (4), others acquired after filing of the bankruptcy case, 11 U.S.C. § 541(a)(5) & (7), and property received after filing which has as its

⁴The debtor improperly claims exemptions under *both* Title 11 and state law. Generally, to the extent they are property of the estate, retirement funds would be exempt under 11 U.S.C. § 522(d)(12) or Wis. Stat. § 815.18(3)(j).

sources property of the estate, 11 U.S.C. § 541(a)(6). Section 541(b) lists interests categorized as outside section 541(a)'s perimeters, and sections 541(c)(2) & (d) detail limitations on the extent to which certain interests are within "property of the estate." 11 U.S.C. § 541(c)(2) & (d).

Section 541(a)(1)'s "all legal and equitable interests of the debtor in property as of the commencement of the case" is broadly construed. United States v. Whiting Pools, Inc., 462 U.S. 198, 204-05, 103 S.Ct. 2309, 2313, 76 L.Ed.2d 515, 521-22 (1983). Along with this standard there are other generally recognized principles for determining property of the estate. One is that section 541(a) does not expand the property interests of a debtor beyond those held at the moment a bankruptcy case is started. See, e.g., Matter of Jones, 768 F.2d 923, 927 (7th Cir. 1985); Moody v. Amoco Oil Co., 734 F.2d 1200, 1213 (7th Cir. 1984). Another is what is property of the estate for purposes of bankruptcy laws is a question of federal law while what property interest a debtor possessed at the commencement of a bankruptcy case is, absent a controlling federal law to the contrary, created and defined by state law. Barnhill v. Johnson, 503 U.S. 393, 98, 112 S.Ct. 1386, 1389, 118 L.Ed.2d 39, 46 (1992) ("In the absence of any controlling federal law, 'property' and 'interests in property' are creatures of state law."); Butner v. United States, 440 U.S. 48, 54, 99 S.Ct. 914, 918, 59 L.Ed.2d 136, 141-42 ("Congress has generally left the determination of property rights in the assets of a bankruptcy's estate to state law."); In re Atchison, 925 F.2d 209, 210-11 (7th Cir. 1991). Thus, state law determines whether a prepetition seizure transfers ownership, so as to prevent property from being included in the bankruptcy estate.

As noted above, on November 15, 2004, the family court ordered the appointment of a receiver under section 813.16, Wis. Stats., and Chapter 767, Wis. Stats., to take possession of the

proceeds of the IRA and TSP accounts previously held in the name of the debtor, for the purpose of paying ongoing child support payments to the debtor's former spouse. (Case No. 1999FA001626).

While some courts have determined that in certain circumstances property held by a receiver is not property of the estate, *see*, *e.g.*, *In re Skorich*, 332 B.R. 77 (Bankr. D. N.H. 2005) (proceeds from sale of former marital home that chapter 7 debtor had owned with his estranged wife, having been placed in escrow pursuant to prepetition order of divorce court, were already in custodia legis when bankruptcy petition was filed, were as a consequence not included in "property of the estate," and became property of wife when awarded to her, postpetition, by divorce court), other courts have determined that upon the filing of a petition in bankruptcy, property of a debtor held by a state court appointed receiver becomes property of the estate, *see*, *e.g.*, *In re Weldon F. Stump & Co.*, 337 B.R. 636, 638 (Bankr. N.D. Ohio 2005) (citing *In re Yellow Cab Coop. Ass'n*, 178 B.R. 265 (Bankr. D. Col. 1995)).

Wisconsin law provides:

The receiver or assignee upon qualifying shall be vested by operation of law with the title of the debtor as of the date of the filing of the petition or assignment hereunder, except so far as it is property which is exempt, including:

- (a) Property transferred by the debtor in fraud of the debtor's creditors.
- (b) Property which prior to the filing of the petition or assignment the debtor could by any means have transferred or which might have been levied upon and sold under judicial process against the debtor.
- (c) Rights of action arising upon contracts or from the unlawful taking or detention of or injury to the debtor's property.

Wis. Stat. § 128.19(1). This is not to say that the receiver is vested with title to all of the debtor's property. As stated by the Wisconsin Supreme Court:

A receiver in aid of execution is authorized to collect those assets revealed by the

examination of the debtor, take possession of them, apply them to the satisfaction of the judgment, and return the excess to the judgment debtor. ... In *United States Rubber* Products, Inc., v. Twin Highway Tire Co., [233 Wis. 234, 244, 288 N.W. 179, 183 (1940)], this court held that, when the court commissioner "appointed the receiver of the debts, property, equitable interests, rights, choses in action, chattels, business, and good-will of the judgment debtor, all of his beneficial interest therein passed by operation of law to the receiver in so far as necessary to effectuate the purposes of supplementary proceedings." (Emphasis supplied.) The parties misinterpret this passage in *United States* Rubber when they assert that a receiver upon his appointment is vested with title to all of the debtor's property. Title to all of the debtor's property can vest in a receiver only by statute. 1 Clark on Receivers, sec. 226 (3d ed. 1959). Under sec. 128.19, Stats., a Chapter 128 receiver is "vested by operation of law with title of the debtor" as of the date the petition for the proceeding is filed. No such statute exists with respect to Chapter 273, Stats., 1973, receivers [renumbered 816.03 to 816.11]. A Chapter 273 [currently Chapter 816] receiver in aid of execution acts not as administrator of the debtor's estate but as a collection agent for the specific judgment creditors whose interests he represents.

Candee v. Egan, 84 Wis. 2d 348, 362-63, 267 N.W.2d 890, 897 (1978). See also In re Adams Machinery, Inc., 20 Wis. 2d 607, 623, 123 N.W.2d 558, 566 (1963) (chapter 128 "has the effect of putting the receiver in the position of a creditor who has obtained a lien by judicial process"). While the receivers in this case were appointed under section 813.16, Wis. Stats., not chapter 816, Wis. Stats., that is a distinction without a difference. The receiver's duty under both chapters is the same: to hold possession of the property in question for the court, and administer it strictly in accordance with the directions of the court. See Bogert's Trusts and Trustees § 14 Receivership (2009 update). A receiver is not regarded as personally in possession of the debtor's property. The legal possession is in the appointing court. Id.

I am satisfied that the debtor has an interest in these former retirement funds, albeit very limited, sufficient to bring them into the estate, if it were appropriate to do so. Rightly or wrongly, Mr. Larsen did not reinvest the funds in rollover accounts within 60 days of having his father withdraw them. They lost their status at that time. With the funds awarded to him in the

property division and held in cash, there is no question the court could set up a receivership for the payment of future support. *See* Wis. Stat. §§ 767.61(4), 767.77. Even if the funds had been reinvested in a retirement vehicle, the state court could have established the receivership just as it did. *See* Wis. Stat. § 815.18(3)(j)5. This, too, would have constituted a withdrawal, and the funds would have lost their exempt status. So whether they are traceable to a retirement account or would qualify for reinvestment in an exempt retirement vehicle is a red herring. By the time of filing, we would still be looking at the funds as they are now – funds withdrawn from former retirement accounts and held by a child support receivership. They are not exempt for bankruptcy purposes, and Mr. Larsen has no right to remove them from the estate.

Section 542 of the Bankruptcy Code establishes a broad policy that anyone holding property of the estate at filing must deliver the property to the trustee or debtor in possession or account for its value. An exception to this duty is that no turnover obligation will arise if the property is in the hands of a receiver, non-bankruptcy trustee, assignee for the benefit of creditors, or similar custodian. 11 U.S.C. § 542(a). Nevertheless, under section 543 of the Code, custodians, such as receivers, non-bankruptcy trustees, and assignees for the benefit of creditors, *may* be forced to turn over property to a trustee or debtor in possession and to account for such property.

A court may excuse the custodian's compliance with the turnover requirements if (1) "the interests of creditors ... would be better served by permitting a custodian to continue in possession, custody, or control of such property" and (2) "the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to

prevent fraud or injustice." 11 U.S.C. § 543(d). This exception is a "modified abstention provision, akin to the abstention provisions found in section 305 of the Code," and whether the court decides to apply section 543(d)(1) is based on the exercise of its discretion. *In re Dill*, 163 B.R. 221, 225 (E.D.N.Y. 1994). Because the state court receiver took possession of the subject assets more than 120 days before the filing of the petition, we must determine whether the creditors would be better served by permitting the receiver to continue in possession of the property and whether turnover is necessary to prevent fraud or injustice.

Section 1334(c)(1) of Title 28 of the United States Code confers upon this Court the power to exercise its discretion and abstain from hearing certain matters, providing in relevant part: "Nothing ... prevents a district court in the interest of justice, or in the interest of comity with State courts or respect for State law, from abstaining from hearing a particular proceeding arising under title 11 or arising in or related to a case under title 11." Likewise, 11 U.S.C. § 305 gives the discretion to abstain if the interests of creditors and the debtor would be better served by such suspension.

In determining the propriety of employing abstention, courts utilize those traditional considerations related to the function served by the abstention doctrine: respect for federalism.

Matter of Chicago, Milwaukee, St. Paul & Pac. R.R. Co., 6 F.3d 1184, 1189 (7th Cir. 1993).

Although not a complete list, important considerations in this regard include, (1) the extent to which state law issues predominate over bankruptcy issues, (2) the presence of a related proceeding commenced in state court or other nonbankruptcy court, (3) the jurisdictional basis, if any, other than 28 U.S.C. § 1334, (4) the degree of relatedness or remoteness of the proceeding to the main bankruptcy case, (5) the substance rather than form of an asserted "core" proceeding,

(6) the feasibility of severing state law claims from core bankruptcy matters to allow judgments to be entered in state court with enforcement left to the bankruptcy court, and (7) the presence in the proceeding of nondebtor parties. *Id*.

When placed within the confines of this legal framework, abstention becomes highly appropriate in this matter. The former retirement funds were put into this receivership for the purpose of paying the debtor's child support. If they were considered exempt under state law, other creditors would have no right to recover from these funds. If they lost their status on account of the debtor's withdrawal through his power of attorney, or not, they were still subject to the receivership and payment of future support. I know of no public policy that would sanction allowing the debtor to file a bankruptcy case to thwart payment of child support (as has already occurred), to gain control of assets under the jurisdiction of another court, or to redirect payments from his children to other creditors. Even the trustee acknowledges that the estate's interest in these assets is subject to the superceding interest of the children for future support. The state court has and should continue to determine the rights of the parties in the funds placed in receivership in 2004.

While the debtor also alleges that the state court illegally took possession of his property, under the *Rooker-Feldman* doctrine, federal courts lack jurisdiction over federal actions which essentially invite federal courts to review and reverse unfavorable state court judgments. *See Rooker v. Fidelity Trust Co.*, 263 U.S. 413, 44 S.Ct. 149, 68 L.Ed. 362 (1923); *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 103 S.Ct. 1303, 75 L.Ed.2d 206 (1983). This Court may not redress "cases brought by state-court losers complaining of injuries caused by state-court judgments." *Exxon Mobil Corp. v. Saudi Basic Indus. Corp.*, 544 U.S. 280, 284, 125

S.Ct. 1517, 161 L.Ed.2d 454 (2005). His rights in both the retirement assets and the Magnum Opus assets are the subject of state court appeals, and this court abstains from any determination with respect to those rights. The trustee is ordered to return the funds received from the receiver paying child support to that receiver forthwith.

This court earlier determined that the funds of the Magnum Opus trust that are now being held by the attorneys for the judgment creditors pursuant to the state court's order are not exempt. For the same reasons stated above, the debtor has an interest in them, limited as it is by the state court's orders, and they are property of the estate under the control of a custodian. The trustee has indicated he intends to file a motion for turnover, although he has not done so at this time. I am satisfied that the voluminous record now before me has fleshed out the issues relevant to such a motion, and justice will be better served by deciding now to abstain with respect to the various parties' interests in the Magnum Opus funds. Turnover is not necessary to prevent fraud or injustice; to the contrary, turnover would very likely precipitate an injustice, i.e., by causing further delay and additional administrative expenses. Cannon & Dunphy can hold the funds in that firm's trust account or disburse them as directed by the state court, pending final resolution by the state court appeals or supreme court. Since the appeals are still pending, any change in the rights of the parties will be monitored by Cannon & Dunphy on behalf of the judgment creditors, as well as by the debtor. Likewise, the appeals can be monitored by the trustee on behalf of the estate in case the various parties' interests in the funds change.

Aside from the judgment creditors (who may hold a nondischargeable obligation), the debtor also listed his divorce attorney and various credit card companies as unsecured creditors. The taxing authorities also filed claims. However, I am satisfied there is no overriding

bankruptcy interest in taking jurisdiction over the Magnum Opus funds. True, other creditors might share with the judgment creditors under a bankruptcy scenario, whereas they would not under the receivership scenario. Nevertheless, even though the judgment creditors have not moved to dismiss this case, Congress has expressed a policy of noninterference by bankruptcy courts with state court remedies for victims of violent crimes, and these judgment creditors most definitely qualify. *See* 11 U.S.C. § 707(c)(2). This court will abstain from exercising jurisdiction over the Magnum Opus funds that are held by Cannon & Dunphy in its trust account. This abstention is without prejudice to reimposition of jurisdiction at a later date if subsequent litigation modifies the rights of interested parties in these funds.

Furthermore, the Court notes that the automatic stay is no longer applicable to the pending receivership proceedings. Because this is the debtor's second bankruptcy case within one year, the stay terminated 30 days postpetition pursuant to 11 U.S.C. § 362(c)(3).

A separate order will be entered accordingly.

November 3, 2009

Margaret Dee McGarity

Chief Judge, U.S. Bankruptcy Court